CLIENT ALERTS

New Tax Legislation Contains a Variety of Employee Benefits Provisions

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This E-News Alert briefly summarizes some of the employee benefits provisions in the Tax Cuts and Jobs Act (the "TCJA") – i.e. the tax reform legislation – recently passed by Congress and expected to be signed by the President into law. Please contact the author of this E-News alert, any member of the Butzel Long employee benefits practice group, or your regular Butzel Long attorney contact for more information.

Health care: Elimination of individual mandate

Under the Patient Protection and Affordable Care Act (also called the Affordable Care Act, or "ACA"), individuals must be covered by a health plan that provides at least minimum essential coverage or be subject to a tax (also referred to as a penalty) for failure to maintain the coverage (commonly referred to as the "individual mandate").

Under the TCJA, for months beginning *after* December 31, *2018*, the amount of the tax is reduced to zero. (Hence, the individual mandate is still in effect for 2018.)

Health care: Modification of medical expense deduction

Individuals may claim an itemized deduction for unreimbursed medical expenses, but only to the extent that such expenses exceed 10 percent of their adjusted gross income. (For taxable years beginning before January 1, 2017, the 10-percent threshold was reduced to 7.5 percent in the case of taxpayers who had attained the age of 65 before the close of the taxable year.)

Under the TCJA, for the 2017 and 2018 tax years, the threshold for deducting medical expenses is 7.5% for all taxpayers. For 2019 and beyond, the threshold returns to 10%.

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Retirement benefits: Extended period to rollover a plan loan offset amount

Background – Prior to the TCJA

A plan may provide that, in certain circumstances (for example, if an employee terminates employment), an employee's obligation to repay a loan is accelerated and, if the loan is not repaid, the loan is cancelled and the amount of the employee's account balance is offset by the amount of the unpaid loan balance, referred to as a loan offset. A loan offset is treated as an actual distribution from the plan equal to the unpaid loan balance, and the amount of the distribution is eligible for tax-free rollover to another eligible retirement plan within 60 days. (However, the plan is not required to offer a direct rollover with respect to a plan loan offset amount that is an eligible rollover distribution, and the plan loan offset amount is generally not subject to 20-percent income tax withholding.)

Change made by TCJA

Under the TCJA, the period during which a qualified plan loan offset amount may be contributed to an eligible retirement plan as a rollover contribution is extended from 60 days after the date of the offset -- to the due date (including extensions) for filing the Federal income tax return for the taxable year in which the plan loan offset occurs, (i.e. the taxable year in which the amount is treated as distributed from the plan). Under the TCJA, a qualified plan loan offset amount is a plan loan offset amount that is treated as distributed from a qualified retirement plan, a section 403(b) plan or a governmental section 457(b) plan solely by reason of the termination of the plan or the failure to meet the repayment terms of the loan because of the employee's severance from employment. The provision is effective for taxable years beginning after December 31, 2017.

Tax-Exempt Organizations: New excise tax on excess executive compensation

The TCJA enacts a new excise tax for tax-exempt organizations if they pay excess executive compensation.

Under the TCJA, an *employer* is liable for an excise tax equal to 21 percent of the sum of:

(1) any remuneration (other than an excess parachute payment described below) in excess of $1 million paid to a covered employee by an applicable tax-exempt organization for a taxable year, and

(2) any excess parachute payment paid by the applicable tax-exempt organization to a covered employee. Accordingly, the excise tax applies as a result of an excess parachute payment, even if the covered employee's remuneration does not exceed $1 million.

For purposes of the provision, a covered employee is an employee (including any former employee) of an applicable tax-exempt organization if the employee is one of the *five highest* compensated employees of the organization for the taxable year or was a covered employee of the organization (or a predecessor) for any preceding taxable year beginning after December 31, 2016. An "applicable tax-exempt organization" is an organization exempt from tax under Internal Revenue Code section 501(a), an exempt farmers' cooperative, a Federal, State or local governmental entity with excludable income, or a political organization.

Under the provision, an excess parachute payment is the amount by which any parachute payment exceeds the portion of the base amount allocated to the payment. A parachute payment is a payment in the nature of compensation to a covered employee if the payment is contingent on the employee's separation from employment and the aggregate present value of all such payments equals or exceeds three times the base amount. (The base amount is the average annualized compensation includible in the covered employee's gross income for the five taxable years ending before the date of the employee's separation from employment.) Parachute payments do not include payments under a qualified retirement plan, a simplified employee pension plan, a simple retirement account, a tax-deferred annuity, or an eligible deferred compensation plan of a State or local government employer.

The employer of a covered employee is liable for the excise tax.

Remuneration is treated as paid when there is no substantial risk of forfeiture of the rights to such remuneration (pursuant to Internal Revenue Code section 457(3)(B)). In addition, the definition of remuneration for this purpose includes amounts required to be included in gross income under section 457(f).

Accordingly, the tax imposed by this provision can apply to the value of remuneration that is vested (and any increases in such value or vested remuneration) under this definition, *even if it is not yet received by the employee*.

Compensation paid to employees who are not highly compensated employees is exempted from the definition of parachute payment, and compensation attributable to medical services of certain qualified medical professionals is exempted from the definitions of remuneration and parachute payment. For purposes of determining a covered employee, remuneration paid to a licensed medical professional which is directly related to the performance of medical or veterinary services by such professional is not taken into account, whereas remuneration paid to such a professional in any other capacity is taken into account. A medical professional for this purpose includes a doctor, nurse, or veterinarian.

The provision is effective for taxable years beginning after December 31, 2017.

Tax-Exempt Organizations: adjustment to unrelated business income tax

Unrelated business income tax ("UBIT") generally applies to income derived from a trade or business regularly carried on by the organization that is not substantially related to the performance of the organization's tax-exempt functions. Under the TCJA, unrelated business taxable income includes any expenses paid or incurred by a tax-exempt organization for qualified transportation fringe benefits, qualified parking, or any on-premises athletic facility. Presumably, the intent of this provision is to place a tax-exempt employer in a similar position as a taxable employer with regard to these benefits (see below discussion).

Income tax treatment of employer stock transferred to an employee

Specific rules apply to property, including employer stock, transferred to an employee in connection with the performance of services. These rules govern the amount and timing of income inclusion by the employee and the amount and timing of the employer's compensation deduction.

Under these rules, an employee generally must recognize income in the taxable year in which the employee's right to the stock is transferable or is not subject to a substantial risk of forfeiture, whichever occurs earlier. Thus, if the employee's right to the stock is substantially vested when the stock is transferred to the employee, the employee recognizes income in the taxable year of such transfer, in an amount equal to the fair market value of the stock as of the date of transfer (less any amount paid for the stock). If at the time the stock is transferred to the employee, the employee's right to the stock is not substantially vested, the employee does not recognize income attributable to the stock transfer until the taxable year in which the employee's right becomes substantially vested.

Very generally stated, a new detailed provision under the TCJA allows non-publicly traded corporations to offer rank and file employees the opportunity to defer income tax inclusion on compensatory stock options or restricted stock units for as long as 5 years (although the time period could be shorter than 5 years if a variety of circumstances occur). The corporation must have a written plan under which not less than 80% of all employees who provide services to the corporation in the U.S. are granted stock options or restricted stock units with the same rights and privileges to receive qualified stock.

This special deferral rule is not available to an employee (a) who owns more than 1% of the corporation (at any time during the preceding 10 years) or (b) who is (or at any prior time was) the chief executive officer or chief financial officer of the corporation, or (c) who is a family member of any of the previously described individuals or (d) who has been one of the 4 highest compensated officers of the corporation for any of the 10 preceding years.

A corporation which transfers qualified stock to a qualified employee must provide a notice to the qualified employee at the time the employee's right to qualified stock is substantially vested.

The provision is effective for tax years after 2017. Please contact Butzel Long to learn more information about this detailed provision.

Elimination/Adjustments of Deductions for Certain Fringe Benefits

Background – Prior to the TCJA

No deduction is allowed with respect to an activity generally considered to be entertainment, amusement, or recreation ("entertainment"), unless the taxpayer establishes that the item was directly related to the active conduct of the taxpayer's trade or business. If the taxpayer establishes that entertainment expenses are directly related to the active conduct of its trade or business, the deduction generally is limited to 50 percent of the amount otherwise deductible.

Similarly, a deduction for any expense for food or beverages generally is limited to 50 percent of the amount otherwise deductible.

In addition, no deduction is allowed for membership dues with respect to any club organized for business, pleasure, recreation, or other social purpose.

Certain employer-provided fringe benefits are excluded from an employee's gross income and wages for employment tax purposes, including, but not limited to, *de minimis* fringes, qualified transportation fringes, on-premises athletic facilities, and meals provided for the "convenience of the employer."

(Qualified transportation fringes include qualified parking (parking on or near the employer's business premises or on or near a location from which the employee commutes to work by public transit), transit passes, vanpool benefits, and qualified bicycle commuting reimbursements.)

The value of meals furnished to an employee or the employee's spouse or dependents by or on behalf of an employer for the convenience of the employer is excludible from the employee's gross income, but only if such meals are provided on the employer's business premises.

TCJA

The TCJA provides that no deduction is allowed with respect to (1) an activity generally considered to be entertainment, amusement or recreation, (2) membership dues with respect to any club organized for business, pleasure, recreation or other social purposes, or (3) a facility or portion thereof used in connection with any of the above items. *Thus, the provision eliminates the present law deduction for entertainment, amusement, or recreation that is directly related to the active conduct of the taxpayer's trade or business* (and the related rule applying a 50 percent limit to such deductions).

In addition, *the TCJA eliminates a deduction for expenses associated with providing any qualified transportation fringe to employees of the taxpayer, and any expense incurred for providing transportation (or any payment or reimbursement) for commuting between the employee's residence and place of employment* (except as necessary for ensuring the safety of an employee).

Please note that employers can still sponsor qualified transportation fringe benefit plans so that employees may elect pre-tax salary reductions for qualified transportation fringe benefits. The value of the income and employment tax exclusion to *employees* remains the same. However, to the extent employees make pre-tax elections, *employers* will not be able to deduct the costs of those benefits.

Taxpayers may still generally deduct 50 percent of the food and beverage expenses associated with operating their trade or business (*e.g.*, meals consumed by employees on work travel).

For amounts incurred and paid after December 31, 2017 and until December 31, 2025, the TCJA expands this 50 percent limitation to expenses of the employer associated with providing food and beverages to employees through an eating facility that meets requirements for *de minimis* fringes and for the convenience of the employer (e.g. an employee cafeteria on employer business premises). Such amounts incurred and paid after December 31, 2025 are not deductible.

The provision generally applies to amounts paid or incurred after December 31, 2017.

Elimination of exclusion for qualified bicycle commuting reimbursement

Prior to the TCJA, qualified bicycle commuting reimbursements of up to $20 per qualifying bicycle commuting month are excludible from an employee's gross income.

The TCJA eliminates the exclusion from gross income for qualified bicycle commuting reimbursements. The elimination of the exclusion applies for taxable years beginning after December 31, 2017 and before January 1, 2026.

Elimination of exclusion/deduction for qualified moving expenses

Prior to the JCTA, employees may exclude from their gross income employer-provided moving expense reimbursement. Under the JCTA, effective for taxable years beginning after December 31, 2017 (and through 2025), employees can no longer exclude from their gross income employer-provided moving expense reimbursement. (The exclusion still applies, though, for a member of the Armed Forces of the U.S. on active duty who moves pursuant to a military order.)

Prior to the JCTA, individuals are permitted a deduction for moving expenses paid or incurred during the year in connection with the commencement of work as an employee or as a self-employed individual at a new principal place of work. Under the JCTA, effective for taxable years beginning after December 31, 2017 (and through 2025), the deduction is no longer available. (Generally speaking, the deduction still applies, though, for a member of the Armed Forces of the U.S. on active duty who moves pursuant to a military order.)

Adjustment to deductibility and exclusion for employee achievement awards

An employer's deduction for the cost of an employee achievement award is limited to a certain amount. Employee achievement awards that are deductible by an employer are excludible from an employee's gross income.

The JCTA limits the deductibility for the employer – and the exclusion by the employee - of employee achievement awards to "tangible personal property". Tangible personal property shall not include cash, cash equivalents, gift cards, gift coupons or gift certificates (other than arrangements conferring only the right to select and receive tangible personal property from a limited array of such items pre-selected or pre-approved by the employer), or vacations, meals, lodging, tickets to theater or sporting events, stocks, bonds, other securities, and other similar items. In other words, cash and cash-equivalent employee achievement awards will not qualify for tax-free treatment.

The provision applies to amounts paid or incurred after December 31, 2017.

New employer credit for paid family and medical leave

The TCJA allows eligible employers to claim a general business credit equal to 12.5 percent of the amount of wages paid to qualifying employees during any period in which such employees are on family and medical leave if the rate of payment under the program is 50 percent of the wages normally paid to an employee. The credit is increased by 0.25 percentage points (but not above 25 percent) for each percentage point by which the rate of payment exceeds 50 percent. The maximum amount of family and medical leave that may be taken into account with respect to any employee for any taxable year is 12 weeks.

An eligible employer is one who has in place a written policy that allows all qualifying full-time employees not less than two weeks of annual paid family and medical leave, and who allows all less-than-full-time qualifying employees a commensurate amount of leave on a pro rata basis. For purposes of this requirement, leave paid for by a State or local government – or leave required by a State law or local government ordinance - is not taken into account.

“Family and medical leave” is defined as leave described under the Family and Medical Leave Act of 1993. If an employer provides paid leave as vacation leave, personal leave, or other medical or sick leave, this paid leave would not be considered to be family and medical leave.

This provision only applies to wages paid in taxable years 2018 and 2019.

Executive Compensation: Publicly traded companies: Internal Revenue Code section 162(m): $1 million limit on deductible compensation for an employer

Background – Prior to the TCJA

An employer generally may deduct reasonable compensation for personal services as an ordinary and necessary business expense. Section 162(m) of the Internal Revenue Code provides an explicit limitation on the deductibility of compensation expenses in the case of publicly traded corporate employers. The otherwise allowable deduction for compensation with respect to a “covered employee” of a publicly held corporation is limited to no more than $1 million per year.

Under Internal Revenue Service guidance, “covered employee” means any employee who is (1) as of the close of the taxable year, the principal executive officer (or an individual acting in such capacity) defined in reference to the Securities Exchange Act of 1934, or (2) among the three most highly compensated officers for the taxable year (other than the principal executive officer or principal financial officer).

A publicly held corporation means any corporation issuing any class of common equity securities required to be registered under section 12 of the Securities Exchange Act of 1934.

Certain types of compensation are not subject to the deduction limit and are not taken into account in determining whether other compensation exceeds $1 million - such as: (1) remuneration payable on a commission basis and (2) remuneration payable solely on account of the attainment of one or more performance goals if certain outside director and shareholder approval requirements are met ("performance-based compensation").

TCJA

The TCJA revises the definition of "covered employee" to include both the principal executive officer and the principal financial officer. Further, an individual is a covered employee if the individual holds one of these positions at any time during the taxable year. The provision also defines as a covered employee the three (rather than four) most highly compensated officers for the taxable year (other than the principal executive officer or principal financial officer) who are required to be reported on the company's proxy statement for the taxable year (or who would be required to be reported on such a statement for a company not required to make such a report to shareholders). In addition, if an individual is a covered employee with respect to a corporation for a taxable year beginning after December 31, 2016, the individual remains a covered employee for all future years.

The TCJA extends the applicability of section 162(m) to include all domestic publicly traded corporations and all foreign companies publicly traded through American depository receipts (ADRs).

The TCJA eliminates the exceptions for commissions and performance-based compensation from the definition of compensation subject to the deduction limit.

The provision applies to taxable years beginning after December 31, 2017. A detailed transition rule applies to remuneration which is provided pursuant to a written binding contract which was in effect on November 2, 2017 and which was not modified in any material respect on or after such date.

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